

Cutting the Odds by Reading the Table

When playing poker,
you look for telltale
twitches or shakes;
when playing the
market, you seek
out indications
of interest you can
respond to profitably
while avoiding ones
that expose
your own hand

By Steve Raaen

POKER ISN'T GAMBLING THE way that playing roulette is gambling. True, in an honest game, you have no control over the cards you draw. But when it comes time to bet and to apply psychological skills to outfox fellow players, luck has very little to do with the outcome.

A similar set of rules govern outcomes when you're trading large blocks of stock. There's no way to know in advance whether the value of the shares will ultimately go up or down. But by cleverly reading the signals of other players' intentions toward those securities—signals transmitted via indications of interest (IOIs)—you often can gain a very important trading edge.

When traders need to move large blocks of securities, it's crucial that the rest of the market not learn of their intentions. Revealing intentions in those situations adversely affects execution no matter what side of the

market a trader is on. If you're a buy-side trader, for example, indications of interest offer opportunities to play your hand efficiently and effectively while keeping facts about your own holdings protected from other players in the market.

To drum up business, position traders and market makers have been known to send out indications of interest just to remind the buy side that they're involved in certain stocks. Most institutions, however, don't respond to a broker if they believe that's what the broker is doing. To do so could expose their intentions to a broker who has no immediate ability to fill their order. Such IOIs generally are thought of as low-quality indications and for that reason are derisively termed *fishing*.

Because of such fishing excursions, large institutions get affected the most when valuable information is revealed to the sell side. That's because when a large buy-side institution indicates interest in buying a specific stock, it can drive up the price of the stock before the buyer can complete the purchase.

One way to address challenges involving indications is with FIX—the financial information exchange. FIX is a computer-messaging protocol developed by a number of influential institutions with the aim of improving the quality of indications sent by the sell side. Bloomberg has developed a system that supports the FIX concept. It's the new IOI function, and it lets institutional traders receive information that improves order execution.

The indications of interest tracked on the IOI function are one-line electronic messages sent from broker/dealers to their institutional clients. A typical IOI might read, "Sell

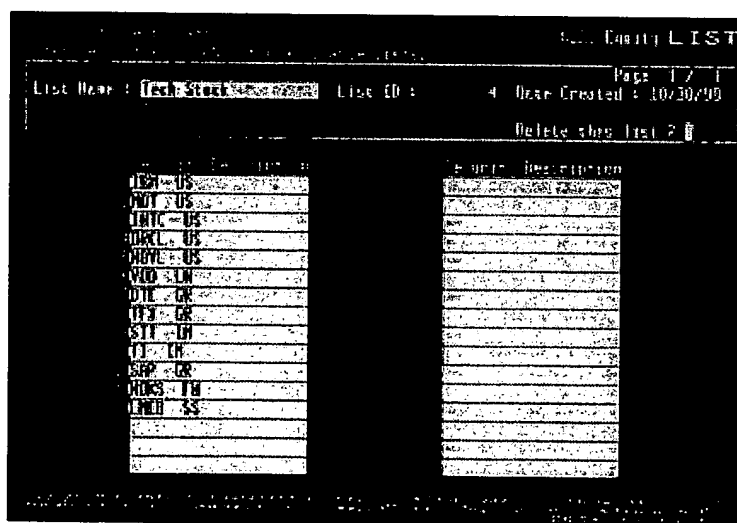


FIGURE 1. Type LIST <Go> 1 <Go>. Tab down, enter a list name, and press <Go>. Enter the tickers of the stocks you want to follow. Press <Go>

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50,000 INTC at 90 MLCO 10:57," which means that at 10:57 a.m. Merrill Lynch is a seller of 50,000 shares of Intel Corp. at 90. Indications are by definition fuzzy. If they were firm, they'd no longer be indications; they'd be orders.

The 50,000 shares Merrill Lynch is selling may or may not be the entire number Merrill's trying to unload. In addition, the 50,000 might be the firm's own position or could represent shares Merrill's trying to sell on behalf of a client. If a broker actually has 5 million shares to sell, that broker rarely would reveal the entire number at once; displaying such a large supply of stock would send the stock's share price plummeting. Displaying the name of the client behind a sale also could have disastrous effects. And in some instances, brokers don't give even an exact size or price; they simply identify themselves as a large seller.

The biggest players in the stock market these days aren't brokers who execute trades; they're large mutual funds acting through brokers. The bigger the fund manager, the bigger the order. The bigger the order, the more it could affect the market. Because people in financial markets know that large institutions are likely to be buying or selling millions of shares of a given stock, it becomes a necessity that as few of those people as possible know when transactions are happening. And the best way an institution can keep the information hidden is to find a broker who knows of another large institution that's naturally on the other side of a desired trade. This phenomenon sometimes is referred to as a natural cross.

Finding the right broker for a trade is not always easy, but if the institution is lucky enough to find one who can cross the trade with a natural, then the result usually is a quick, clean, cheap, and efficient execution. For that reason, institutions are quick to respond to IOIs they believe are natural or that represent a real institutional client on the other side. In such a case, institutions can surmise that the 50,000-share indication may be only part of what the broker has to

| Side | Ref | Label | Price | Graber | Time | Reader | Page |
|------|-----|-------|-------|--------|------|--------|------|
| 1 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 2 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 3 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 4 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 5 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 6 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 7 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 8 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 9 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 10 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 11 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 12 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 13 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 14 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 15 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
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| 17 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 18 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 19 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 20 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 21 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 22 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 23 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 24 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 25 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 26 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 27 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 28 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 29 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 30 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 31 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 32 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 33 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 34 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 35 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 36 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 37 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 38 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 39 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 40 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 41 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 42 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 43 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 44 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 45 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 46 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 47 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 48 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 49 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 50 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 51 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 52 | 100 | 100 | 100 | 100 | | | |

FIGURE 2. Type IOI <Go> 1 <Go> to add a new IOI profile. Tab down and enter information in the NAME and DESCRIPTION fields. Press <Go> <Page Fwd>

offer—that there's more behind it. To facilitate such thinking, some brokers add the word *natural* to their IOIs. Other brokers send only natural indications.

Sometimes, however, an indication represents a residual position that a broker has taken on to accommodate a client. It could happen if a customer wants to sell, say, 300,000 shares but the broker can find a buyer for only 250,000. The broker might then look for a buyer for the other 50,000 by sending out an indication. This is frequently referred to as a trading call.

There's a certain amount of risk when an institution responds to a broker's indication. A broker who will not be carrying through on an indicated intention to trade after being called by the institution has acquired very valuable information nobody else has: information that there's a big order waiting out there. A broker who can execute only 50,000 shares for an institution—leaving the institution with a large block left to trade—also is in possession of valuable information. The only really safe situation—from the selling institution's perspective—is to find a natural cross.

One might wonder why brokers would want institu-

Tip Box

► To see the complete list of functions for indications of interest, type IOIM <Go> for the Indications of Interest main menu.

Type IOIM.<Help> for more information on the function

tions to think their IOIs are natural. If you were pretty sure there was a large buyer of a stock in the market, wouldn't you be tempted to buy a little for yourself—thereby putting more buying pressure on the stock? The answer is found in the mandated behavior of large institutional funds. Such investors are strictly regulated by the government and by charter. Their investment decisions can be made only by a portfolio manager, not by a trader. Even if traders at large fund managers are sure of seeing a short-term trading opportunity, they can't act on it. They can't create an order on the trading desk.

SOME HEDGE FUNDS, THOUGH, are not subject to such restrictions. Their job is to spot short-term opportunities and act on them, so sending natural IOIs to them can have the opposite effect from the one desired: Seeing a large buyer, a hedge fund may be tempted to buy ahead of the sale rather than sell into it, thereby injuring the price of the stock in the process. As an added insult, a hedge fund won't even execute the trade with the broker sending the IOI. In fact, the fund likely would want to trade with anyone but that broker because to do otherwise would be an instant tip-off that the hedge fund is using the broker's information surreptitiously.

Brokers must therefore find a way to avoid being picked off by short-term traders; institutions need more clarity in determining exactly what type of liquidity each indication represents. Bloomberg provides each side of this relationship with what it needs.

Brokers now can better aim their IOIs at specific clients or types of clients. For example, a broker might want to send large fund managers only IOIs that represent natural merchandise so that such clients need not expose their positions to brokers who can't fill the order. At the same time, a broker may opt to send hedge funds and short-term traders all indications, including trading calls. That way, aggressive investors can't be sure

whether there's more product or not behind an IOI. Bloomberg's broker list applications give brokers the flexibility to simply and easily serve each of these client needs.

For institutions the goal is to determine which indications are safe to respond to and which will simply expose their hand. One way to make the determination is to call brokers who give the most detailed information about what they're willing to do.

Brokers who simply say they're large sellers of Intel are really not giving customers much information—though they're giving themselves a lot of wiggle room. If the IOI is more than a couple of minutes old, a broker might have already traded the block. That broker also might be a seller at a lower price or have a definition of *large* that might be considerably different from your own.

A growing number of institutions are demanding timeliness and clarity in messages, and IOI profiles enable such institutions to better control exactly what they see. IOI profiles let you define which indications make it through to your screen: You can ask for only messages with a specific price and/or specific size; you can apply a list of only the stocks you are interested in trading to the profile to ensure relevance; you can even control

Signals transmitted via IOIs often can give an important trading edge

The screenshot shows the Bloomberg Select Securities screen. At the top, it says "Indications & Advertisements: All Indications and Advertisements Page 17/42". Below this is a table with columns: Side, DM, Symbol, Price, Broker, Time, and Trader. The table lists several indications for Intel (INTC) and Microsoft (MSFT). In the center of the screen, there is a "TICKER LISTS" window showing a list of tickers and their corresponding prices. The list includes Intel (INTC) and Microsoft (MSFT) among others.

FIGURE 3. From the Select Securities screen, type 2 <Go> 1 <Go> to select the ticker list created earlier. Type the number of the list, and press <Go>

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| Profile | List | Name | Price | Broker | Trader |
|---------|------|------|-------|--------|--------|
| 1 | 1 | 1 | 1 | 1 | 1 |
| 2 | 2 | 2 | 2 | 2 | 2 |
| 3 | 3 | 3 | 3 | 3 | 3 |
| 4 | 4 | 4 | 4 | 4 | 4 |
| 5 | 5 | 5 | 5 | 5 | 5 |
| 6 | 6 | 6 | 6 | 6 | 6 |
| 7 | 7 | 7 | 7 | 7 | 7 |
| 8 | 8 | 8 | 8 | 8 | 8 |
| 9 | 9 | 9 | 9 | 9 | 9 |
| 10 | 10 | 10 | 10 | 10 | 10 |
| 11 | 11 | 11 | 11 | 11 | 11 |
| 12 | 12 | 12 | 12 | 12 | 12 |
| 13 | 13 | 13 | 13 | 13 | 13 |
| 14 | 14 | 14 | 14 | 14 | 14 |
| 15 | 15 | 15 | 15 | 15 | 15 |
| 16 | 16 | 16 | 16 | 16 | 16 |
| 17 | 17 | 17 | 17 | 17 | 17 |
| 18 | 18 | 18 | 18 | 18 | 18 |
| 19 | 19 | 19 | 19 | 19 | 19 |
| 20 | 20 | 20 | 20 | 20 | 20 |

FIGURE 4. Type 2 <Go> 1 <Go> 1 <Go> 1 <Go> to finish the profile

which brokers make it through to your screen. Once the profile's been established, you can even subscribe to it. The subscription feature generates a real-time message when an IOI is sent. The message flashes at the top of your screen regardless of which Bloomberg screen you're watching. (See box.)

IOIs give a clearer idea of what other market players are doing and why they're doing it. In poker parlance, that's called cutting the odds.

►Any comments? Type MAGAZINE <Msg>. For reprints, type MAGZ <Go>.

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Setting up an IOI profile

WHEN IT COMES TO SEEING INDICATIONS OF interest as they're released, the first step is to set up an IOI profile. The profile enables you to create filters that limit the types of indications you receive, to limit the firms you receive indications from, and/or to limit the securities about which you receive indications. The two general procedures to follow in establishing and using an IOI profile reflect those objectives. First, you create a list of securities to use in the profile. Next, you create the actual profile by using that securities list.

To set up a list of ticker symbols to use in your profile, begin by typing LIST <Go>. Then type 1 <Go> to create a new list. Tab down, enter a name in the LIST NAME field, and press <Go>. On the screen that appears, tab down and in the highlighted fields, enter ticker symbols followed by <Equity>. After the last ticker's been entered, press <Go> (figure 1).

The next step in using IOI is to set up your actual profile. Begin by typing IOI <Go> 1 <Go> to add a

new profile. Tab down to the two fields in the Profile Title box in the middle of the screen, and enter a name and short description. Press <Go>. Now you can press <Page Fwd> to customize your profile. In the Step 1 box that appears, type 2 <Go> 1 <Go> and select the list created during the previous procedure (figures 2 and 3). Steps 2 through 4 let you set alerts for when new indications are sent; set the type of indications to receive; and set the specific brokers from whom you'll receive indications. Type 1 <Go> from step 5 to monitor indications based on the profile you've just created (figure 4).

Finally, you can further tailor the function to your own specifications by using related functions. For example, to let brokers know you'd like to see their IOIs, register with them by typing IREG <Go>. You also can see IOIs on an individual stock by typing the stock's ticker followed by <Equity> IIRA <Go>.

For more information on creating and customizing the IOI function, download an instruction sheet. Type DOCS VIEWING INDICATIONS <Go>. —S.R.

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